

§ 1.874-1 Allowance of deductions and credits to nonresident alien individuals.

(a) *Return required.* A nonresident alien individual shall receive the benefit of the deductions and credits otherwise allowable with respect to the income tax, only if the nonresident alien individual timely files or causes to be filed with the Philadelphia Service Center, in the manner prescribed in subtitle F, a true and accurate return of the income which is effectively connected, or treated as effectively connected, with the conduct of a trade or business within the United States by the nonresident alien individual. No provision of this section (other than paragraph (c)(2)) shall be construed, however, to deny the credits provided by sections 31, 32, 33, 34 and 852(b)(3)(D)(ii). In addition, notwithstanding the requirement that a nonresident alien must file a timely return in order to receive the benefit of the deductions and credits otherwise allowable with respect to the income tax, the nonresident alien individual may, for purposes of determining the amount of tax to be withheld under section 1441 from remuneration paid for labor or personal services performed within the United States, receive the benefit of the deduction for personal exemptions provided in section 151, to the extent allowable under section 873(b)(3) and paragraph (c)(3) of § 1.873-1, or in any applicable tax convention, by filing a claim therefore with the withholding agent. The amount of the deduction for the personal exemptions and the amount of the tax to be withheld under those circumstances shall be determined in accordance with paragraph (e)(2) of § 1.1441-3. The deductions and credits allowed such a nonresident alien individual electing under a tax convention to be subject to tax on a net basis may be obtained by filing a return of income in the manner prescribed in the regulations (if any) under the tax convention or under any other guidance issued by the Commissioner.

(b) *Filing deadline for return—(1) General rule.* As provided in paragraph (a) of this section, for purposes of computing the nonresident alien individual's taxable income for any taxable

year, otherwise allowable deductions and credits will be allowed only if a true and accurate return for that taxable year is filed by the nonresident alien individual on a timely basis. For taxable years of a nonresident alien individual ending after July 31, 1990, whether a return for the current taxable year has been filed on a timely basis is dependent upon whether the nonresident alien individual filed a return for the taxable year immediately preceding the current taxable year. If a return was filed for that immediately preceding taxable year, or if the current taxable year is the first taxable year of the nonresident alien individual for which a return is required to be filed, the required return for the current taxable year must be filed within 16 months of the due date, as set forth in section 6072 and the regulations under that section, for filing the return for the current taxable year. If no return for the taxable year immediately preceding the current taxable year has been filed, the required return for the current taxable year (other than the first taxable year of the nonresident alien individual for which a return is required to be filed) must have been filed no later than the earlier of the date which is 16 months after the due date, as set forth in section 6072, for filing the return for the current taxable year or the date the Internal Revenue Service mails a notice to the nonresident alien individual advising the nonresident alien individual that the current year tax return has not been filed and that no deductions or credits (other than those provided in sections 31, 32, 33, 34 and 852(b)(3)(D)(ii)) may be claimed by the nonresident alien individual.

(2) *Waiver.* The filing deadlines set forth in paragraph (b)(1) of this section may be waived if the nonresident alien individual establishes to the satisfaction of the Commissioner or his or her delegate that the individual, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return (including a protective return (as described in paragraph (b)(6) of this section)). For this purpose, a nonresident alien individual shall not be considered to have acted reasonably and in good faith if

the individual knew that he or she was required to file the return and chose not to do so. In addition, a nonresident alien individual shall not be granted a waiver unless the individual cooperates in determining his or her U.S. income tax liability for the taxable year for which the return was not filed. The Commissioner or his or her delegate shall consider the following factors in determining whether the nonresident alien individual, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return—

(i) Whether the individual voluntarily identifies himself or herself to the Internal Revenue Service as having failed to file a U.S. income tax return before the Internal Revenue Service discovers the failure to file;

(ii) Whether the individual did not become aware of his or her ability to file a protective return (as described in paragraph (b)(6) of this section) by the deadline for filing the protective return;

(iii) Whether the individual had not previously filed a U.S. income tax return;

(iv) Whether the individual failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account his or her relevant experience and level of sophistication), the individual was unaware of the necessity for filing the return;

(v) Whether the individual failed to file a U.S. income tax return because of intervening events beyond the individual's control; and

(vi) Whether other mitigating or exacerbating factors existed.

(3) *Examples.* The following examples illustrate the provisions of paragraph (b). In all examples, A is a nonresident alien individual and uses the calendar year as A's taxable year. The examples are as follows:

Example 1. Nonresident alien individual discloses own failure to file. In Year 1, A became a limited partner with a passive investment in a U.S. limited partnership that was engaged in a U.S. trade or business. During Year 1 through Year 4, A incurred losses with respect to A's U.S. partnership interest. A's foreign tax advisor incorrectly concluded that because A was a limited partner and had only losses from A's partnership interest, A was not required to file a U.S. income

tax return. A was aware neither of A's obligation to file a U.S. income tax return for those years nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. In Year 5, A began realizing a profit rather than a loss with respect to the partnership interest and, for this reason, engaged a U.S. tax advisor to handle A's responsibility to file U.S. income tax returns. In preparing A's U.S. income tax return for Year 5, A's U.S. tax advisor discovered that returns were not filed for Year 1 through Year 4. Therefore, with respect to those years for which applicable filing deadlines in paragraph (b)(1) of this section were not met, A would be barred by paragraph (a) of this section from claiming any deductions that otherwise would have given rise to net operating losses on returns for these years, and that would have been available as loss carryforwards in subsequent years. At A's direction, A's U.S. tax advisor promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 through Year 4 and by making A's books and records available to an Internal Revenue Service examiner. A has met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in paragraph (b)(1) of this section.

Example 2. Nonresident alien individual refuses to cooperate. Same facts as in *Example 1*, except that while A's U.S. tax advisor contacted the appropriate examining personnel and filed the appropriate income tax returns for Year 1 through Year 4, A refused all requests by the Internal Revenue Service to provide supporting information (for example, books and records) with respect to those returns. Because A did not cooperate in determining A's U.S. tax liability for the taxable years for which an income tax return was not timely filed, A is not granted a waiver as described in paragraph (b)(2) of this section of any applicable filing deadlines in paragraph (b)(1) of this section.

Example 3. Nonresident alien individual fails to file a protective return. Same facts as in *Example 1*, except that in Year 1 through Year 4, A also consulted a U.S. tax advisor, who advised A that it was uncertain whether U.S. income tax returns were necessary for those years and that A could protect A's right subsequently to claim the loss carryforwards by filing protective returns under paragraph (b)(6) of this section. A did not file U.S. income tax returns or protective returns for those years. A did not present evidence that intervening events beyond A's control prevented A from filing an income tax return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of

any applicable filing deadlines in paragraph (b)(1) of this section.

Example 4. Nonresident alien with effectively connected income. In Year 1, A, a computer programmer, opened an office in the United States to market and sell a software program that A had developed outside the United States. A had minimal business or tax experience internationally, and no such experience in the United States. Through A's personal efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. A, however, did not file U.S. income tax returns for Year 1 or Year 2. A was aware neither of A's obligation to file a U.S. income tax return for those years, nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. In November of Year 3, A engaged U.S. counsel in connection with licensing software to an unrelated U.S. company. U.S. counsel reviewed A's U.S. activities and advised A that A should have filed U.S. income tax returns for Year 1 and Year 2. A immediately engaged a U.S. tax advisor who, at A's direction, promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 and Year 2 and by making A's books and records available to an Internal Revenue Service examiner. A has met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in paragraph (b)(1) of this section.

Example 5. IRS discovers nonresident alien's failure to file. In Year 1, A, a computer programmer, opened an office in the United States to market and sell a software program that A had developed outside the United States. Through A's personal efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. A had extensive experience conducting similar business activities in other countries, including making the appropriate tax filings. A, however, was aware neither of A's obligation to file a U.S. income tax return for those years, nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. Despite A's extensive experience conducting similar business activities in other countries, A made no effort to seek advice in connection with A's U.S. tax obligations. A failed to file either U.S. income tax returns or protective returns for Year 1 and Year 2. In November of Year 3, an Internal Revenue Service examiner asked A for an explanation of A's failure to file U.S. income tax returns. A immediately engaged a U.S. tax advisor, and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1

and Year 2 and by making A's books and records available to the examiner. A did not present evidence that intervening events beyond A's control prevented A from filing a return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in paragraph (b)(1) of this section.

Example 6. Nonresident alien with prior filing history. A began a U.S. trade or business in Year 1 as a sole proprietorship. A's tax advisor filed the appropriate U.S. income tax returns for Year 1 through Year 6, reporting income effectively connected with A's U.S. trade or business. In Year 7, A replaced this tax advisor with a tax advisor unfamiliar with U.S. tax law. A did not file a U.S. income tax return for any year from Year 7 through Year 10, although A had effectively connected income for those years. A was aware of A's ability to file a protective return for those years. In Year 11, an Internal Revenue Service examiner contacted A and asked for an explanation of A's failure to file income tax returns after Year 6. A immediately engaged a U.S. tax advisor and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 7 through Year 10 and by making A's books and records available to the examiner. A did not present evidence that intervening events beyond A's control prevented A from filing a return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in paragraph (b)(1) of this section.

(4) **Effective date.** Paragraphs (b)(2) and (3) of this section are applicable to open years for which a request for a waiver is filed on or after January 29, 2002.

(5) **Income tax treaties.** A nonresident alien individual who has a permanent establishment or fixed base, as defined in an income tax treaty between the United States and the country of residence of the nonresident alien individual, in the United States is subject to the filing deadlines as set forth in paragraph (b)(1) of this section.

(6) **Protective return.** If a nonresident alien individual conducts limited activities in the United States in a taxable year which the nonresident alien individual determines does not give rise to gross income which is effectively connected with the conduct of a trade or business within the United States as defined in sections 871(b) and

864 (b) and (c) and the regulations under those sections, the nonresident alien individual may nonetheless file a return for that taxable year on a timely basis under paragraph (b)(1) of this section and thereby protect the right to receive the benefit of the deductions and credits attributable to that gross income if it is later determined, after the return was filed, that the original determination was incorrect. On that timely filed return, the nonresident alien individual is not required to report any gross income as effectively connected with a United States trade or business or any deductions or credits but should attach a statement indicating that the return is being filed for the reason set forth in this paragraph (b)(4). If the nonresident alien individual determines that part of the activities which he or she conducts in the United States in a taxable year gives rise to gross income which is effectively connected with the conduct of a trade or business and part does not, the nonresident alien individual must timely file a return for that taxable year to report the gross income determined to be effectively connected, or treated as effectively connected, with the conduct of that trade or business within the United States and the deductions and credits attributable to the gross income. In addition, the nonresident alien individual should attach to that return the statement described in this paragraph (b)(4) with regard to the other activities. The nonresident alien individual may follow the same procedure if the nonresident alien individual determines initially that he or she has no United States tax liability under the provisions of an applicable income tax treaty. In the event the nonresident alien individual relies on the provisions of an income tax treaty to reduce or eliminate the income subject to taxation, or to reduce the rate of tax to which that income is subject, disclosure may be required pursuant to section 6114.

(c) *Allowed deductions and credits*—(1) *In general.* Except for losses of property located within the United States, charitable contributions and personal exemptions (see section 873(b)), deductions are allowed to a nonresident alien individual only to the extent they are

connected with gross income which is effectively connected, or treated as effectively connected, with the conduct of the nonresident alien individual's trade or business in the United States. Other than credits allowed by sections 31, 32, 33, 34, and 852(b)(3)(D)(ii), the nonresident alien individual is entitled to credits only if they are attributable to effectively connected income. See paragraph (a) of this section for the requirement that a return be timely filed. Except as provided by section 906, a nonresident alien individual shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(2) *Verification.* At the request of the Internal Revenue Service, a nonresident alien individual claiming deductions from gross income which is effectively connected or treated as effectively connected, with the conduct of a trade or business in the United States and credits attributable to that income must furnish at the place designated pursuant to §301.7605-1(a) information sufficient to establish that the nonresident alien individual is entitled to the deductions and credits in the amounts claimed. All information must be furnished in a form suitable to permit verification of the claimed deductions and credits. The Internal Revenue Service may require, as appropriate, that an English translation be provided with any information in a foreign language. If a nonresident alien individual fails to furnish sufficient information, the Internal Revenue Service may in its discretion disallow any claimed deductions and credits in full or in part.

(d) *Return by Internal Revenue Service.* If a nonresident alien individual has various sources of income within the United States, so that from any one source, or from all sources combined, the amount of income shall call for the assessment of a tax greater than that withheld at the source in the case of that individual, and a return of income has not been filed in the manner prescribed by subtitle F, including the filing deadlines set forth in paragraph (b)(1) of this section, the Internal Revenue Service shall:

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(1) Cause a return of income to be made.

(2) Include on the return the income described in § 1.871-7 or § 1.871-8 of that individual from all sources concerning which it has information, and

(3) *Assess the tax.* If the nonresident alien individual is not engaged in, or does not receive income that is treated as being effectively connected with, a United States trade or business and § 1.871-7 is applicable, the tax shall be assessed on the basis of gross income without allowance for deductions or credits (other than the credits provided by sections 31, 32, 33, 34 and 852(b)(3)(D)(ii)) and collected from one or more sources of income within the United States. If the nonresident alien individual is engaged in a United States trade or business or is treated as having effectively connected income and § 1.871-8 applies, the tax on the income of the nonresident alien individual that is not effectively connected, or treated as effectively connected with the conduct of a United States trade or business shall be assessed on the basis of gross income, determined in accordance with the rules of § 1.871-7, without allowance for deductions or credits (other than the credits provided by sections 31, 32, 33, 34 and 852(b)(3)(D)(ii)) and collected from one or more of the sources of income within the United States. Tax on income that is effectively connected, or treated as effectively connected, with the conduct of a United States trade or business shall be assessed in accordance with either section 1, 55 or 402(e)(1) without allowance for deductions or credits (other than the credits provided by sections 31, 32, 33, 34 and 852(b)(3)(D)(ii)) and collected from one or more of the sources of income within the United States.

(e) *Alien resident of Puerto Rico, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands.* This section shall not apply to a nonresident alien individual who is a bona fide resident of Puerto Rico, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands during the

entire taxable year. *See* section 876 and § 1.876-1.

[T.D. 8322, 55 FR 50828, Dec. 11, 1990; 56 FR 1361, Jan. 14, 1991, as amended by T.D. 8981, 67 FR 4174, Jan. 29, 2002; T.D. 9043, 68 FR 11313, Mar. 10, 2003]

§ 1.875-1 Partnerships.

Whether a nonresident alien individual who is a member of a partnership is taxable in accordance with subsection (a), (b), or (c) of section 871 may depend on the status of the partnership. A nonresident alien individual who is a member of a partnership which is not engaged in trade or business within the United States is subject to the provisions of section 871 (a) or (b), as the case may be, depending on whether or not he receives during the taxable year an aggregate of more than \$15,400 gross income described in section 871(a), if he is not otherwise engaged in trade or business within the United States. A nonresident alien individual who is a member of a partnership which at any time within the taxable year is engaged in trade or business within the United States is considered as being engaged in trade or business within the United States and is therefore taxable under section 871(c). For definition of what the term "partnership" includes, see section 7701(a)(2) and the regulations in part 301 of this chapter (Regulations on Procedure and Administration). The test of whether a partnership is engaged in trade or business within the United States is the same as in the case of a nonresident alien individual. *See* § 1.871-8.

§ 1.875-2 Beneficiaries of estates or trusts.

(a) [Reserved]

(b) *Exception for certain taxable years.* Notwithstanding paragraph (a) of this section, for any taxable year beginning before January 1, 1975, the grantor of a trust, whether revocable or irrevocable, is not deemed to be engaged in trade or business within the United States merely because the trustee is engaged in trade or business within the United States.